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No. 87-1174

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1987

APPLICATION OF STERLING BANCORP,

Appellant,

-against-

NEW YORK CITY DEPARTMENT OF FINANCE and PHILIP R. MICHAEL, Commissioner of Finance,

Appellees.

On Appeal from the Supreme Court
of the State of New York, Appellate Division,
First Judicial Department

MOTION TO DISMISS

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TABLE OF CONTENTS

	Page
QUESTIONS PRESENTED	2
PRELIMINARY STATEMENT	3
STATEMENT OF THE CASE	4
POINT I:	
APPELLANT'S CLAIM UNDER THE COMMERCE CLAUSE DOES NOT PRESENT A SUBSTANTIAL FEDERAL QUESTION BECAUSE APPELLANT HAS NOT SHOWN THAT ANY OF ITS INCOME WAS DERIVED FROM ACTIVITIES IN THE BAHAMAS	10
POINT II:	
APPELLANT'S EQUAL PROTECTION ISSUE WAS NEITHER TIMELY RAISED, NOR EXPRESSLY PASSED UPON, IN THE NEW YORK COURTS	14
POINT III:	
THE APPEAL PRESENTS NO SUBSTANTIAL FEDERAL QUESTION UNDER THE EQUAL PROTECTION CLAUSE, BOTH BECAUSE (1) THE EQUAL PROTECTION CLAIM RESTS UPON AN ERRONEOUS PREMISE AND (2) A STATE, OR POLITICAL SUBDIVISION THEREOF, MAY TAX A CORPORATION DOMICILED IN THAT STATE MORE HEAVILY THAN ONE DOMICILED ELSEWHERE	17

A. Appellant's equal protection claim is based upon an erroneous premise 17

B. In any event, the Equal Protection Clause does not bar a state, or political subdivision thereof, from taxing its own domiciliaries more heavily than non-domiciliaries 19

CONCLUSION 21

TABLE OF AUTHORITIES

Cases	Page
Allied Stores v. Bowers, 358 U.S. 522 (1959)	19, 20
Bd. of Dirs. of Rotary Int'l v. Rotary Club, __U.S.__ Slip Op., 107 S. Ct. 1940 (1987)	16
Butler Bros. v. McColgan, 315 U.S. 501 (1942)	10
Cardinale v. Louisiana, 394 U.S. 437 (1969)	16
Container Corp. v. Franchise Tax Bd., 463 U.S. 159 (1983)	10,12, 13
Di Bella v. Di Bella, 47 NY2d 828, 392 N.E.2d 564 (1979)	14
Ellis v. Dixon, 349 U.S. 458 (1955)	16
Exxon Corp. v. Wisconsin Dept. of Revenue, 447 U.S. 207 (1980)	10, 12
Matter of Hood & Sons v. DuMond, 297 N.Y. 209, 78 N.E.2d 476 (1948), rev'd on other grounds 336 U.S. 525, 300 N.Y. 480, 88 N.E.2d 661 (1949)	14
Japan Line v. County of Los Angeles, 441 U.S. 434 (1979)	12, 13
Jongebloed v. Erie Railroad Co., 296 N.Y. 912, 72 N.E.2d 627 (1947)	15

Page

Lehnhausen v. Lake Shore Auto Parts Co., 410 U.S. 356 (1973) 21

Lynch v. New York, 293 U.S. 52 (1934). 16

Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. 425 (1980) 12

National Organization for Women v. State Div. of Human Rights, 32 NY2d 940, 300 N.E.2d 733 (1973) ... 15

Norfolk & Western R. Co. v. North Carolina ex rel. Maxwell, 297 U.S. 682 (1936) 10

Rast v. Van Deman & Lewis, 240 U.S. 342 (1916) 20

Rector, etc. of Church of Holy Trinity v. Melish, 301 N.Y. 679, 95 N.E.2d 43 (1950) 15

Regan v. Taxation With Representation of Wash., 461 U.S. 540 (1983)..... 21

Schillawski v. State of New York, 9 NY2d 235, 173 N.E.2d 793 (1961) 14

Tax Commissioners v. Jackson, 283 U.S. 527 (1931) 20

Matter of Van Dyk Berg, 35 N.Y.2d 966, 324 N.E.2d 558 (1974) 15

Wein v. Levitt, 42 NY2d 300, 366 N.E.2d 847 (1977) 14

Page

United States Constitution

Art. 1, §8, cl. 3 ..... 2, 13

Am. XIV, equal protection cl. 17, 19, 20

Statutes

New York Civil Practice Law and Rules, §5601(b) 15

New York City Administrative Code

§R46-37.1 ..... 7, 11

§R46-37.4 ..... 7, 11

§R46-37.53 (a)(1) 7, 11

Other Authority

New York State Tax Commission Advisory Opinion to Lloyds Bank 18

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MOTION TO DISMISS

Appellees move to dismiss the appeal on the following grounds:

1. None of the questions stated in the Jurisdictional Statement presents a substantial federal question.

2. Appellant's question relating to the Equal Protection Clause of the United States Constitution was neither timely nor properly raised, nor expressly passed on by the courts of New York.

QUESTIONS PRESENTED

1. Did the Foreign Commerce Clause of the United States Constitution (Art. I, §8, cl. 3) require appellees to permit allocation of a bank's net income under the New York City financial corporation tax where the record shows that the bank's principal and branch offices were in the City, that this was the only place where the bank's functions were regularly carried on, and that a claimed "branch" in the Bahamas was a mere legal device to enable the bank to engage in Eurodollar transactions?

2. Was appellant's claim under the Equal Protection Clause of the United States Constitution timely raised and preserved, or expressly passed upon by the New York courts?

3. If so, did denial of allocation of net income to the bank's claimed Bahamian branch deny the bank equal protection of the laws on the theory that a bank having its principal office in another state and also a Bahamian "branch" might carry on the business of that "branch" in New York City, as appellant did with respect to its Bahamian "branch", without incurring City financial corporation tax liability?

PRELIMINARY STATMENT

The appeal is from a judgment of the Appellate Division of the Supreme Court, First Department, of the State of New York, entered March 10, 1987, which unanimously confirmed, without opinion, a determination of appellee Commissioner of Finance that appellant owed New York City financial corporation tax. J.S. A-29* By an order entered July 7, 1987, the Court of

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*References preceded by "J.S." refer to pages in appellant's Jurisdictional Statement or appendix thereto.

Appeals of the State of New York, sua sponte, dismissed an appeal taken to it as of right on constitutional grounds for lack of a substantial constitutional question. J.S. A-31. Appellant then moved for leave to appeal. By an order entered October 20, 1987, the Court of Appeals denied appellant's motion. J.S. A-32.

The determination of appellee Commissioner of Finance was issued after a hearing at which evidence was taken and findings made. See Decision and Findings at J.S. A-17 to A-28.

STATEMENT OF THE CASE

Appellant is a bank holding company, incorporated under the laws of New York with its principal place of business in New York City. It filed combined New York City financial corporation tax returns with its subsidiaries for the tax years in question, i.e., the 1980 and 1981 calendar years.

Sterling National Bank and Trust Company of New York ("SNB") is one of the subsidiaries included in appellant's combined returns.

During the tax years in question, SNB had both its principal office and various branch offices in New York City (8 offices in 1980 and 7 in 1981). It had no place of business outside the City, other than a claimed "branch" in Nassau, the Bahamas, maintained by an unrelated company, World Banking Corp., Ltd., for an annual fee of $10,000.

The Nassau "branch" was in a room, approximately 20 by 40 feet in size, which was shared with approximately 46 other corporations, most of which were banks. There were only three or four desks in the room. The premises had neither teller windows, nor name plates on the desks indicating loan officers. No banking hours were listed on the door to the office. When the appellees' chief investigator visited the office in January, 1983, in midday on a business workday, there was only one employee on the premises. Although SNB had a listing for the premises in the Nassau telephone directory, it

shared the telephone with other corporations. J.S. A-23 to A-24.

All transactions of the Nassau "branch" originated and occurred in New York City, and its records were kept in the City. All decisions regarding the investment of the funds reported as Nassau branch funds were made by an investment committee located in New York City. The funds were all deposited in time deposits in foreign banks, the foreign branches of domestic banks, or the International Banking Facilities of other banks. J.S. A-22. In granting permission for the establishment of the Nassau "branch", the Federal Reserve Board specified that there was to be no contact with the local public at the branch. J.S. A-21. Indeed, appellant concedes that virtually all of the functions of the Nassau branch were performed by personnel in SNB's New York City branches. J.S. 5. Moreover, it produced no witness at the administrative hearing before appellees with personal knowledge of what, if anything, was done at the Nassau

"branch". While SNB's agreement with World Banking Corp., Ltd., provided that the latter would supply SNB with a branch manager and an assistant branch manager, and that these persons were to have separate contracts with SNB, their salaries, if any, were to be paid to World Banking Corp. The $10,000 paid to World Banking for each of the years in question included the salaries of these part-time "employees", who were also employees of World Banking. J.S. A-22.

The New York City financial corporation tax is imposed on every banking corporation for the privilege of doing business in the City in a corporate or organized capacity. New York City Administrative Code, §R46-37.1. The basic tax during the years in question was 13.823% of entire net income or the portion thereof allocated to the City. Id., §R46-37.53(a)(1). The law provides for allocation where entire net income is derived from business carried on both within and without the City. Id., §R46-37.4. The tax

applies only to that portion of the net income derived from a taxpayer's activities in New York City. Ibid.

Based on the evidence presented at the administrative hearing, appellees found that all of the net income in question arose from appellant's activities in New York City. Appellant failed to prove that any of the income it claimed should be allocated to Nassau arose from activities carried on in Nassau. While appellees found that SNB was duly licensed by the Bahamian Minister of Finance to open a branch in Nassau and had the permission of the Federal Reserve Board to do so, they concluded that the "branch" claimed was a mere legal device, set up for the sole purpose of enabling appellant to participate in the Eurodollar market. J.S. A-20 to A-21, A-27.

If the appellant had established at the administrative hearing that a portion of its net income arose from activities regularly carried on in the Nassau office, an appropriate allocation

would have been allowed.* However, the mere maintenance of a Nassau address to obtain relief from various federal banking restrictions should not preclude the City from taxing income derived from activities within the City.

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*Despite SNB's minimal contact with Nassau, it allocated 64% of its net income to Nassau in 1980 and 68% in 1981. This was achieved by allocating almost no expenses to Nassau.

POINT I

APPELLANT'S CLAIM UNDER THE COMMERCE CLAUSE DOES NOT PRESENT A SUBSTANTIAL FEDERAL QUESTION BECAUSE APPELLANT HAS NOT SHOWN THAT ANY OF ITS INCOME WAS DERIVED FROM ACTIVITIES IN THE BAHAMAS.

A

SNB's claimed "branch" in Nassau, the Bahamas, was a branch in name only. While apparently SNB was authorized to carry on business in Nassau, the business so far as the record shows was, in fact, carried on only in SNB's New York City offices. This Court has long held that the taxpayer has the distinct burden of showing by clear and cogent evidence that a state tax results in extraterritorial values being taxed. Container Corp. v. Franchise Tax Bd., 463 U.S. 159, 164, 175-176 (1983); Exxon Corp. v. Wisconsin Dept. of Revenue, 447 U.S. 207, 221 (1980); Butler Bros. v. McColgan, 315 U.S. 501, 507 (1942); Norfolk & Western R. Co. v. North Carolina ex rel. Maxwell, 297 U.S. 682, 688 (1936). Not only has appellant failed to

meet this burden, but it concedes that virtually all of the functions of the Nassau "branch" were performed by personnel in SNB's New York City offices. J.S. 5.

As New York City's tax is on the privilege of doing business in the City in corporate or organized form, measured by the net income derived from that business [N.Y.C. Admin. Code §§R46-37.1, R46-37.53(a)], it was proper for appellees to deny allocation with respect to the Nassau "branch" since that business was conducted entirely in the City.* Certainly there was no multiple tax burden resulting from the denial since the Bahamas did not tax SNB's income.

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*When net income is derived from business carried on both within and without the City, it is allocated so that only the portion derived from business carried on within the City is taxed. N.Y.C. Admin. Code §§R46-4.0, R46-37.53(a).

B

Appellant relies primarily on Japan Line, Ltd., v. County of Los Angeles, 441 U.S. 434 (1979) for its contentions with respect to foreign commerce. However, this Court has repeatedly distinguished Japan Line in cases involving income taxes as opposed to property taxes. Container Corp. v. Franchise Tax Bd., 463 U.S. 159, 185-197 (1983)*; Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. 425, 448 (1980); Exxon Corp. v. Wisconsin Dept. of Revenue, 447 U.S. 207, 228-229 (1980). These cases indicate that the reasons for allocation to a single situs carry little force in the case of income taxation.

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*In Container Corp. the Court noted that it deliberately emphasized in Japan Line the narrowness of the question presented: "whether instrumentalities of commerce that are owned, based and registered abroad and that are used exclusively in international commerce, may be subjected to apportioned ad valorem property taxation by a State." 463 U.S. at 187, ftn. 24.

The present case is also distinguishable from Japan Line in that:

1. It involves a tax measured by income rather than a property tax.

2. There is no duplication of tax as there was on the containers in Japan Line.

3. There is no treaty or federal policy barring the tax.

4. SNB and appellant are respectively incorporated under the laws of the United States and the State of New York, rather than under the laws of a foreign nation. Thus, there is no problem of possible retaliatory taxation as in Japan Line. Moreover, New York City is both the commercial domicile and headquarters of SNB and appellant.

As no extraterritorial values have been taxed and as no federal treaty or policy has been violated, the tax in question does not contravene the Foreign Commerce Clause under the analysis applied in Container Corp., supra.

POINT II

APPELLANT'S EQUAL PROTECTION ISSUE WAS NEITHER TIMELY RAISED, NOR EXPRESSLY PASSED UPON, IN THE NEW YORK COURTS.

This Court should not entertain the appeal based upon appellant's equal protection question as it was not timely raised, nor was it expressly passed upon by the State courts.

The New York Court of Appeals will not consider a constitutional issue unless it has been raised in a lower court. Schillawski v. State of New York, 9 NY2d 235, 240, 173 N.E.2d 793, 795-796 (1961); Wein v. Levitt, 42 NY2d 300, 305-306, 366 N.E.2d 847, 850 (1977); Di Bella v. Di Bella, 47 NY2d 828, 392 N.E.2d 564 (1979). It will suffice to raise the constitutional issue in the brief submitted in the intermediate appellate court, the Appellate Division. Matter of Hood & Sons, Inc., v. Du Mond, 297 N.Y. 209, 213, 78 N.E.2d 476, 477 (1948), rev'd on other grounds 336 U.S. 525, 300 N.Y. 480, 88 N.E.2d 661 (1949).

A similar rule applies when a litigant seeks to appeal to the New York Court of Appeals as of right on constitutional grounds, pursuant to New York Civil Practice Law and Rules, §5601(b), as appellant did in this case. An appeal taken pursuant to this provision must rest on a constitutional issue raised in the courts below. Rector, etc. of Church of Holy Trinity v. Melish, 301 N.Y. 679, 95 N.E.2d 43 (1950); National Organization for Women v. State Div. of Human Rights, 32 NY2d 940, 300 N.E.2d 733 (1973); Matter of Van Dyk Berg, 35 NY2d 966, 324 N.E.2d 558 (1974). In this instance, also, it is sufficient to have raised the constitutional issue in a brief at the Appellate Division level. Jongebloed v. Erie Railroad Co., 296 N.Y. 912, 72 N.E.2d 627 (1947).

Appellant, however, did not raise an equal protection issue until it filed its jurisdictional statement in the New York Court of Appeals when it sought to appeal to that Court as of right. Thus, under New York law, the equal

protection issue was not timely raised and could not be the basis for an appeal as of right.

Moreover, the Court of Appeals did not expressly rule upon the equal protection issue. Although it dismissed the appeal "upon the ground that no substantial constitutional question is directly involved" (J.S. A-31), appellant's equal protection issue could not have been "directly involved" as that issue was not raised in the court below.*

Generally, this Court will not review a final judgment of a state court unless the federal claim has been properly raised or necessarily decided in the state court proceedings. Bd. of Dirs. of Rotary Int'l v. Rotary Club, __U.S.__,__ (slip op. 13-16), 107 S.Ct. 1940, 1948 (1987); Cardinale v. Louisiana, 394 U.S. 437 (1969); Ellis v. Dixon, 349 U.S. 458 (1955); Lynch v. New York, 293 U.S. 52 (1934).

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*Appellant's Commerce Clause issue was raised in its brief in the court below.

POINT III

THE APPEAL PRESENTS NO SUBSTANTIAL FEDERAL QUESTION UNDER THE EQUAL PROTECTION CLAUSE, BOTH BECAUSE (1) THE EQUAL PROTECTION CLAIM RESTS UPON AN ERRONEOUS PREMISE AND (2) A STATE, OR POLITICAL SUBDIVISION THEREOF, MAY TAX A CORPORATION DOMICILED IN THAT STATE MORE HEAVILY THAN ONE DOMICILED ELSEWHERE.

As shown under Point II, this Court should not review appellant's equal protection claim as it was neither timely raised, nor passed upon, by the New York Courts. However, even had the equal protection claim been properly raised, it does not warrant this Court's review for the separate reasons discussed below.

A. Appellant's equal protection claim is based upon an erroneous premise.

Appellant's equal protection claim is based upon the erroneous premise, that a bank with its principal office and branches in California and a branch in Nassau, the Bahamas, may maintain an office in New York City at which its personnel perform all the services for the Nassau branch that SNB performed for its Nassau branch and

not be subject to the City's financial corporation tax. J.S. 10. It relies upon an Advisory Opinion of the New York State Tax Commission, dealing with the operation of a loan production office in New York City by a California bank, for this conclusion. J.S. 8-10.

However, the Advisory Opinion merely held that the activities of the contemplated loan production office (soliciting loans, assembling credit information, making property inspections and appraisals) would not amount to doing a banking business in the City where all loans were to be approved in California, all funds disbursed from California, and all payments due in California. Based on these facts, the State Tax Commission opined that the loan production office would not be subject to the State bank tax. See Advisory Opinion to Lloyds Bank of California, J.S. at A-37 et seq.

The activities of the loan production office described in the Advisory Opinion are of a wholly different nature than those involved here.

SNB performed virtually all banking functions for its Nassau "branch" at its New York City offices. Hence, if the California bank, in appellant's hypothetical example, did in New York City for its Nassau branch what SNB did for its Nassau branch, it would be doing a banking business and similarly subject to the City tax. There is no dual standard as appellant claims.

B. In any event, the Equal Protection Clause does not bar a state, or political subdivision thereof, from taxing its own domiciliaries more heavily than non-domiciliaries.

It is settled that the Equal Protection Clause does not bar a state from taxing corporations domiciled therein, while exempting corporations domiciled elsewhere but carrying on the same activity within the state for which a domiciliary is taxed. Allied Stores of Ohio v. Bowers, 358 U.S. 522 (1959). In Allied Stores this Court held that an Ohio ad valorem tax on personal property did not violate the Equal Protection Clause, despite the claim of an Ohio

corporation that it had been denied equal protection by reason of an exemption granted to "nonresidents", a term which included foreign corporations but not domestic corporations.

Allied Stores follows a long line of cases recognizing the very wide discretion of the states in the imposition of taxes. Id., 526-529. Indeed, a classification for tax purposes, though discriminatory, is not arbitrary nor violative of the Equal Protection Clause, if any state of facts reasonably can be conceived that would sustain it. Id., 528; Tax Commissioners v. Jackson, 283 U.S. 527, 537 (1931); Rast v. Van Deman & Lewis, 240 U.S. 342, 357 (1916). The concurring opinion of Justice Brennan in Allied Stores points out that a rational basis for exempting nonresidents "could be found in the concept that it is proper that those who are bound to a state by the tie of residence and accordingly the more permanently receive its benefits are proper persons to bear the primary share of its costs." 358 U.S. at 533. See also,

Lehnhausen v. Lake Shore Auto Parts Co., 410 U.S. 356 (1973); Regan v. Taxation With Representation of Wash., 461 U.S. 540, 547-548 (1983).

CONCLUSION

The appeal should be dismissed.

Dated: February 29, 1988

Respectfully submitted,

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